Economic Outlook

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It seems that people have a hard time these days figuring out how the U.S. economy is doing. Gloomy assessments abound, yet in important respects economic performance has been favorable. This paradoxical situation will probably continue in 1985. Real GNP is expected to register moderate growth; inflation will likely remain in check; and the unemployment rate will likely drift lower. But the strength of the dollar will continue to be a major source of woe for many U.S. corporations, while the large Federal budget deficits will continue to cause anxiety in the financial markets.

The overall record of the U.S. economy was quite respectable last year. Real GNP rose by a substantial 5.6% from the fourth quarter of 1983 to the fourth quarter of 1984, but growth was especially rapid in the first half of the year. As interest rates rose, concern was expressed as to whether the economy could slow down without a recession developing. In fact, the Fed did an admirable job of maneuvering the economy to a soft landing. Real GNP rose by about 4% at an annual rate in the fourth quarter of last year, following a paltry increase of 1.6% in the third quarter.

Recent economic reports reflect continued crosscurrents, but the overall tone is positive. The Conference Board's index of consumer confidence rebounded in January after dropping disconcertingly in December. Domestic auto sales in January totaled 8.4 million units at an annual rate--the highest level since May--while early February sales remain strong. Sales at department stores, however, were hurt by January's unusually bad weather. Real growth will probably be moderate in the first quarter as firms continue to keep relatively tight control over inventories. By the spring the pace of economic activity will likely perk up, as inventories become less of a drag and as the economy responds to the decline in interest rates since late last summer. Real GNP is expected to rise 4.2% from fourth-quarter 1984 to fourth-quarter 1985.

Several analysts expected inflation rates to accelerate last year, either because of normal cyclical pressures or prior rapid growth in the money supply. Instead, the consumer price index rose 4.0% from December 1983 to December 1984, hardly changed from the 3.9% and 3.8% increases in 1982 and 1983. Soft oil prices and the strong dollar will help keep inflation under control this year. Moreover, continued lackluster economic growth in many parts of the world makes it unlikely that commodity prices will contribute to general inflationary pressures as in past expansions. The consumer price index is expected to rise 4.3% from December 1984 to December 1985.

The enlargement of the U.S. merchandise trade deficit during the past few years has been dramatic. The trade deficit in 1984 totaled $123.3 billion, compared to a deficit of $69.4 billion in 1983. The deterioration has been broadly based, except for petroleum imports, which have remained roughly stable. The biggest swing among the major categories has been in machinery and transportation equipment, which went from a net surplus of $14.0 billion in 1979 to a deficit of $33.2 billion in 1984. The 1985 merchandise trade deficit is estimated to total about $148 billion. For many companies, the consequences of such a deficit are grim, despite an otherwise favorable economic environment.

Bernard Schoenfeld

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Economic Forecast

Percent Changes at Annual Rates

	Actual	Actual	Actual	Actual	Actual				Forecast	Actual	Forecast	
	1984				1985				1986	1983-	1984-	1985-
	IV	I	II	III	IV	I	II	III	IV	1984	1985	1986
Gross National Product	6.4	7.1	9.8	9.2	8.9	8.7	7.8	8.2	10.0	10.8	7.9	8.7
Real GNP	3.9	3.1	5.3	4.5	4.0	3.5	2.5	2.5	4.0	6.8	3.9	3.5
GNP Price Deflator	2.4	3.9	4.3	4.5	4.7	5.0	5.2	5.6	5.7	3.7	3.8	5.0

	Actual	Forecast	Actual	Forecast	
	1984: IV	1985: I	1983-1984	1984-1985	1985-1986
Consumer Spending	6.5%	8.6%	8.6%	7.8%	8.1%
Durable Goods	9.8	21.2	13.8	10.5	7.0
Nondurable Goods	5.0	5.8	7.1	5.7	7.1
Services	6.6	7.3	8.5	8.6	9.2
Business Capital Spending	12.7	14.2	20.7	14.1	9.9
Structures	17.1	11.1	15.9	12.9	10.4
Equipment	10.5	16.0	23.5	14.7	9.6
Residential Investment	0.1	3.9	16.8	3.9	0.9
			1984	1985	1986
Change in Inventories	$31.1b.	$26.2b.	$56.8b.	$36.1b.	$56.8b.
Net Exports of Goods and Services	$-64.3b.	$-77.5b.	$-66.3b.	$-81.6b.	$-90.9b.
			1983-1984	1984-1985	1985-1986
Government Purchases	11.9%	8.6%	9.1%	10.3%	9.4%
Federal	19.9	10.2	9.6	14.0	10.5
Defense	21.8	12.6	10.5	12.4	12.2
Other	15.0	4.4	6.9	18.6	5.6
State & Local	6.9	7.5	8.8	7.8	8.6
Corporate Profits Before Tax	-1.1*	-5.3*	15.3	3.8	5.8
Corporate Profits After Tax	-0.3*	-3.6*	14.4	5.2	5.9
Plant and Equipment Expenditures	11.0F	22.1	14.2	8.4	7.1
Real Final Sales#	8.3	3.5	5.0	4.5	3.1
Real Disposable Personal Income	4.2	4.5	6.8	4.5	3.5

Economic Indicators	Recent Data			Actual	Forecast	
	Nov.	Dec.	Jan.	1983-1984	1984-1985	1985-1986
Consumer Price Index**	2.4%	2.4%	n.a.	4.0%	4.3%	5.2%
Producer Price Index for Finished Goods**	3.6	2.4	0.0	1.8	3.6	5.0
Industrial Production	4.8	6.0	4.8	10.7	4.3	3.5
Retail Sales##	1.5	-0.5	0.7	10.2	8.5	7.7
				1984	1985	1986
Auto Sales (millions of units, a.r.)	9.8	11.0	11.1	10.4	10.6	10.0
Housing Starts (millions of units, a.r.)	1.60	1.60	1.83	1.74	1.67	1.50
Unemployment Rate	7.1%	7.2%	7.4%	7.5%	6.9%	6.3%
Merchandise Trade Deficit (a.r.)	$119.2b.	$98.4b.	n.a.	$123.3b.	$148.0b.	$160.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

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#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).

b. = billions a.r. = annual rate F = Forecast